IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

MOBIL OIL CORPORATION, *Petitioner* *vs.* CARL F. MATZEN, et al., *Respondents*	No. 71-1169
AMOCO PRODUCTION COMPANY, *Petitioner* *vs.* LELAND C. WAECHTER, et al., *Respondents*	No. 71-1179
CITIES SERVICE OIL CO., *Petitioner* *vs.* CARL F. MATZEN, et al., *Respondents*	No. 71-1188
SHELL OIL COMPANY, *Petitioner* *vs.* CARL F. MATZEN, et al., *Respondents*	No. 71-1191
FEDERAL POWER COMMISSION, *Petitioner* *vs.* MOBIL OIL CORPORATION, et al, *Respondents*	No. 71-1326

Brief in Opposition for Respondents William Harvey Denman Et Al

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Mobil Oil Corporation, Amoco Production Company and their supporting intervenors, Cities Service Oil Company and Shell Oil Company, have petitioned for certiorari. They were subsequently joined by the

Federal Power Commission. These respondents oppose. Because of the necessity to respond to five separate petitions, this brief is somewhat longer than we would have preferred.

QUESTION PRESENTED

The pivotal issue is solely one of law. It may be fairly stated as follows:

> Is a landowner who grants an oil and gas lease—on which the lessee subsequently discovers and produces natural gas which the lessee sells in interstate commerce for resale—a natural gas company so that royalties owing under the terms of the lease are subject to regulation by the Federal Power Commission?

The Court below answered that question, properly we believe, in the negative.

STATEMENT OF THE CASE

The basic factual context from which that question arises is helpfully uncomplicated.

A landowner grants an oil and gas lease. By authority of that conveyance the lessee drills wells which produce gas. The lessee sells that gas to an interstate pipeline. Pursuant to the lease obligations the lessee pays royalties to the landowner with respect to the lessee's gas production. The landowner reserves none of the gas production. He is not a party to the sale by the lessee nor does he necessarily agree that

the royalty is to be calculated on the basis of the lessee's price to the pipeline.[1]

The Origin of the Litigation

A short explanation of how these cases arose will place the controversy in needed perspective.

William Harvey Denman and other named trustees (the Burnett Trustees) are the owners of the Burnett Ranch in West Texas.[2] A controversy with J. M. Huber Corporation to whom they had granted an oil and gas lease is the genesis of the litigation now before this Court.

Since 1947 Huber had refused to honor its leasehold obligations as to the manner of computing royalties on natural gas production. It used first one excuse and then another for its refusal. After Huber's gas sales became subject to FPC regulation as a result of the 1954 decision in *Phillips*,[3] Huber added a new contention; namely, that such regulation entitled it to disregard the royalty obligations agreed to in its oil and gas lease and unilaterally to substitute a "proceeds" clause of the type which the Burnett Trustees

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[1] In many cases the landowner *does* agree to royalty calculated as a share of the lessee's sales proceeds. In those situations the problem envisioned by petitioners would not ordinarily arise. In very rare instances the lease may entitle a landowner to take, as royalty, a share of the gas in kind and sell it himself to a pipeline. In that event, the landowner would have made a sale to an interstate pipeline which of course would be jurisdictional. But no such situation is involved here and in the gas production industry it would be atypical.

[2] The beneficiaries of the trust are Texas Christian University and an attractive lady by the name of Anne Burnett Windfohr Tandy who lives but a few miles from Texas Christian University in Fort Worth, Texas.

[3] *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

had expressly refused to accept when the lease was granted in 1936.[4]

To resolve the dispute the Burnett Trustees filed suit in the United States District Court which considered and rejected Huber's contentions, including its argument that the FPC was the proper forum for the decision of such controversies.[5] On appeal the Fifth Circuit affirmed the rejection of all of Huber's substantive contentions. With respect to the argument that the lease controversy should proceed before the FPC, it declined judicial consideration of that jurisdictional issue until the Commission had first had a go at it. But the Court meticulously cautioned:

> "Lest we be misunderstood, we emphasize again that this analysis is merely to indicate why we conclude primary jurisdiction reference should be made, the Court all the while disclaims any purpose by what it has said or left unsaid, by its comments, express or implied, of declaring or intimating what its views are on the questions

[4] In *J. M. Huber Corporation v. Denman*, 367 F.2d 104, 109 (5th Cir. 1966), the Court pointedly observed:

> "Realizing as they had to, that the earlier and *rejected* draft of February 19, 1936, had an express 'net proceeds derived from the sale of gas' royalty clause which was in effect replaced by the 'market price' clause (note 4, supra) the Lessee-Producer's reported declarations made through its general counsel — a voice not only of management, but with an articulate awareness of the significance of legal terms — clearly put its construction of a market, not a proceeds, basis on this royalty clause. There were similar representations made to the FPC that under its gas leases 'it is obligated to pay royalty based on the market price at the wellhead.'"

[5] *Denman v. J. M. Huber Corporation*, 251 F.Supp. 746 (N.D. Tex. 1964).

referred for initial decision by the FPC and the arguments pro and con."[6]

Following that mandate, the Burnett Trustees petitioned the Commission for an order disclaiming jurisdiction or, in the alternative and in the event the Commission should assert jurisdiction, an adjudication of the controversy.[7] At that point three other oil companies (Mobil, Western Natural[8], and Amoco) who had litigation with their lessors pending in Kansas petitioned the FPC to take jurisdiction of their cases. The Commission consolidated the three petitions, held hearings, received an examiner's recommendation and, by a 3-2 decision, asserted jurisdiction over the landowners and provided for its implementation. All parties appealed and the Court of Appeals for the District of Columbia reversed, unanimously holding that neither the statutory language nor the Congressional intent justifies such an extension of FPC jurisdiction.

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[6]*J. M. Huber Corporation v. Denman*, 367 F.2d 104, 120-121 (5th Cir. 1966).

[7]In obedience to the Fifth Circuit that procedure was followed notwithstanding this earlier telegraphic disclaimer from the FPC, set out at 367 F.2d 118 n. 49:

". . . Federal Power Commission does not fix royalty rates between a lessor and lessee nor does it have any procedure to adjudicate such a dispute."

[8]Western Natural subsequently settled all of its controversies, leaving only three complaining oil companies. See FPC petition p. 5 footnote 4.

REASONS FOR DENYING THE WRIT

(Summary of the Argument)

The carefully considered opinion of the Court of Appeals faithfully followed this Court's prior decisions. The case presents no unresolved issue of law. Nor, contrary to contentions of *some* of the petitioners, does it reduce FPC jurisdiction. Rather the decision below merely repudiates the efforts of a handful of major companies to *expand* that jurisdiction beyond its statutory limits as clearly defined by this Court:

> ". . . Three things and three only Congress drew within its own regulatory power, delegated by the [Natural Gas] Act to its agent, the Federal Power Commission. These were: (1) the *transportation* of natural gas in interstate commerce; (2) its *sale* in interstate commerce for resale; and (3) natural gas *companies* engaged in such transportation or sale."[9]

The decision below is sound. Neither by granting an oil and gas lease nor by accepting royalties on gas production from that lease does a landowner make a sale of natural gas—in law, in fact, or in substance. The term "sale" is used in the Act in a natural, not a distorted, sense. Typically the lessee sells 100% of the gas and the FPC in fact regulates that 100% sale. There is neither statutory basis nor economic need to extend such regulation behind the sale and to the royalty provisions or other terms of the lease from which the gas is produced.

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[9] *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947). All emphasis in quotations is ours unless noted otherwise.

The theory expressed in the opinion of the Commission majority that a *part* of an oil and gas lease constitutes a jurisdictional sale—while at the same time recognizing that the lease itself is nonjurisdictional—created serious contradictions with the Act itself and was properly reversed by the court below.

The theory expressed in the Commission's petition for certiorari that the lessee is an agent of the landowner so that the sale by the lessee to the pipeline is in reality a sale by the landowner to the pipeline—besides contradicting the Commission's decision below—is clearly contrary to fact. The inescapable consequences of such a theory are self-refuting.

An extension of Commission jurisdiction over provisions of oil and gas leases would inject chaos into an already confused gas regulatory scheme. The legislative history of the Act negates any Congressional intention for FPC regulation of landowners who receive royalties on gas production.

Shell's argument to stretch jurisdiction to whatever affects interstate sales of gas is contrary to the statute itself and to this Court's prior decisions.

The decision below is consistent with this Court's prior decisions. The conflicts which petitioners urge were carefully considered by the court below and properly rejected. There is no rational basis for suggesting that traditional oil and gas lease forms, which were designed by oil companies and in use long before the Natural Gas Act was passed, were a landowners' subterfuge to avoid regulation under that Act.

The controversy is private in nature and of rather limited interest. Petitioners' efforts to find a novel issue of national concern are contrived and unavailing. Their exaggerations in that attempt are extreme and obvious.

ARGUMENT

This case presents one of many types of controversies which arise from time to time between landowners and their oil and gas lessees over the interpretation of oil and gas leases or with respect to operations on those leases. It is of a private nature and—notwithstanding the exaggerated protestations of the four major oil company petitioners—does not involve any crisis issue of monumental national import.

The anomalous effort of those few companies is to expand FPC jurisdiction into new and uncharted areas as a mandatory alternative to judicial resolution of issues which are typically judicial. The lack of candor of some of the petitioners is illustrated by the following comparison of assurances to the Court in two of the petitions for certiorari:

Mobil Petition	Shell Petition
". . . the Commission affirmed exercise of such jurisdiction for almost eighteen past years, but the Court of Appeals has reversed, . . ." (p. 3).	"The issue of jurisdiction over royalty claims is admittedly a new one for the Federal Power Commission as well as the Courts." (p. 15).
". . . a rate regulatory program already operative for almost eighteen years [has] been overturned with no remand to the agency." (p. 25).	

The truth is that the FPC never before has asserted jurisdiction over landowners except in two isolated instances of sales by them of gas reserved in kind.

The pretense that the Commission has heretofore established royalties payable under oil and gas leases is answered by the Commission itself. In an *amicus curiae* memorandum filed at the request of the Fifth Circuit in *J. M. Huber Corporation v. Denman*, 367 F.2d 104 (5th Cir. 1966), the Commission acknowledged that the argument was new to it:

> "Since the Commission has not had occasion to pass upon this important question as to the scope of its jurisdiction, we are not in a position to express any definitive position thereon at this time."[10]

Writing separately in that same Memorandum, Commissioner O'Connor was even more explicit:

> "Inquiring parties have, on numerous occasions, been given the information that gas royalty payments were outside the present regulatory responsibilities of the Commission, and it takes little imagination to conclude that such inaction indicates a lack of jurisdiction. . . . In the context of long understanding of Commission policy, the position is unavoidable that the Natural Gas Act has not up to the present been construed to encompass royalty-owners."[11]

After hearing from all parties the Court below put

[10]Page 2 of Memorandum for the Federal Power Commission Amicus Curiae, filed in *J. M. Huber Corporation v. Denman*, 367 F.2d 104 (5th Cir. 1966).

[11]Ibid. p. 23.

this matter in focus:

> "The Act was passed in 1938 and it has not heretofore been construed to apply to ordinary lessors. While inaction is not controlling on intent, the widespread assumption and acquiescence therein, including administrative and legislative acquiescence, extending over such a great period of time is not lightly to be brushed aside."[12]

The magnitude of the statutory stretch which petitioners seek to evoke from this Court is exposed by Amoco's description of "the instant case involving jurisdiction over many thousands of royalty interest owners" and its footnote reference to witnesses who "estimated the number to be hundreds of thousands in Louisiana alone".[13] The Congress has found no need to confer such regulatory jurisdiction. Nor should this Court do so.

The Decision Below Is Sound

Petitioners would support the extension of jurisdiction which they seek by urging that a landowner receiving royalties from a producer on gas production from land is a natural gas company who makes a "sale" of gas in interstate commerce for resale. The Court below, in a carefully reasoned opinion, correctly concluded that a landowner simply does not make a sale of gas:

> "To refer to the royalty owner as engaging in the sale is to depart from the common understanding of the words used, industry parlance,

[12]Shell pet., App. pp. 8a-9a.
[13]Amoco pet. 15.

> economic equivalent, or any other foundation hitherto considered a source for discerning Congressional intention."[14]

The three members of the Commission who urged the jurisdictional extension disapproved by the Court below never really came to grips with the decisive question, "Where is any *sale* by a landowner?" Commissioner Carver, dissenting, perceptively exposed this fatal deficiency in the reasoning of the FPC majority:

> "In order to support a finding that royalty owners have participated in a sale of natural gas, it is essential that some specific operative act, some definite transaction, be identified as having the legally accepted characteristics of a 'sale' . . . We don't know the majority's theory in this respect, because the issue, and indeed the whole matter of how a sale occurs, is evaded by a forensic *tour de force*. The fact of a sale is declared, rather than demonstrated by any acceptable rationale."[15]

To contrive a sale where none exists petitioners imply that the concept of a "sale" as that term is used in the Act—and presumably in this Court's decision[16]—carries some mysterious yet-to-be-articulated definition. Such an approach defies the established guidance from this Court:[17]

> "As we have often said, 'the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.' "

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[14]Shell pet., app. p. 15a.
[15]Shell pet., app. p. 47a.
[16]See note 9 page 6 above.
[17]*Mulat* v. *Riddell*, 383 U.S. 569, 571 (1966); *McNally* v. *Hill*, 293 U.S. 131 (1934); see *Old Colony RR* v. *Comm'r.*, 284 U.S. 552, 560 (1932).

And, as pointed out by the Court below:

> "This canon is given reinforcement for this term because 'sale' was *not* one of the terms for which Congress provided an express or supplemental definition in § 2 ('Definitions') of the Natural Gas Act."[18]

It is one thing to declare that the FPC is not bound by Hornbook definitions or local decisions not applicable to the Natural Gas Act. But, as Commissioner Carver insisted, this is not to say the Commission is:

> ". . . at liberty to enlarge that principle into an unrestricted license to snatch our own definitions out of the cosmos, hand-tailored to fit the case, any more than problems of consideration can be swept away by denigrating reference to established legal concepts."[19]

Elsewhere petitioners sidestep the issue by question-begging phrases. Thus Mobil argues that "Commission regulation has applied to the entire *stream* of natural gas regardless of these classifications of interests under state law."[20] But Congress told the FPC to regulate "sales", not "streams". Typically the sale of *all* of the gas—8/8ths, not just 7/8ths—is made by the lessee to the pipeline. As the Court of Appeals wrote:

> "The lease terms give the lessee all possessory interests in gas produced during the life of the lease, including full right of sale."[21]

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[18]Shell pet. app. p. 9a.
[19]Shell pet., app. p. 48a.
[20]Shell pet., app. p. 10a.
[21]Mobil pet. 3-4.

That sale of the full stream *is* regulated. And the lessee-seller is likewise regulated as a "natural gas company engaged in such sale".

In considering whether the landowner has made a "sale in interstate commerce", three questions are basic and inescapable:

1. What instrument embodies the terms of sale?
2. Who is the seller?
3. Who is the buyer?

If there were a sale by a landowner, one of two instruments would embody its terms—either the oil and gas lease between the landowner and the lessee-producer or the gas sales contract between the lessee-producer and the interstate pipeline. The contrast between the two is obvious even from a cursory reading.[22] Petitioners themselves are not in agreement as to which of the instruments constitutes the alleged "landowner's sale". And the explanation in the Commission's petition is at odds with the explanation in the Commission majority's opinion which was reversed by the Court below.

The oil company petitioners advocate landowner jurisdiction by arguing that the oil and gas lease is an interstate sale—or, more accurately, that a *part* of the oil and gas lease is an interstate sale. This was the theory of the Commission majority reversed by the Court below. Chairman White argued:

[22] A typical example of an oil and gas lease is found at R 82 and of a gas purchase contract at R 96. "R" references are to the printed appendix filed with the Court below.

> "The royalty payment provisions of oil and gas leases constitute a sale for resale of natural gas in interstate commerce subject to regulation under the Natural Gas Act and the royalty owners are natural gas companies for purposes of the Act."[23]

Recognizing, as they must, that an oil and gas lease is *not* a sale of gas under any previously accepted understanding of the term, petitioners try to carve out a part of the lease and call it a sale. Mobil, for instance, refers to "the *part* of the lessor-lessee transaction held to be jurisdictional".[24] And Amoco insists that "The only provision of the oil and gas leases . . . before the Court is" the royalty covenant.[25]

That effort to torture a lease provision into a sale by excising one clause from the entirety of the lease not only would rewrite the lease contract by the technique of massive deletion but it would also fly in the teeth of express statutory prohibitions against ignoring other parts of an allegedly regulated sale contract. Congress has imposed Commission responsibility, not merely over the rates of natural gas companies, but over:

> ". . . the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services."[26]

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[23]Shell pet., app. p. 39a.

[24]Mobil pet. 23 – italics by Mobil.

[25]Amoco pet. 6.

[26]Natural Gas Act, § 4(c), 52 Stat. 822, 15 U.S.C. § 717c(c).

If the oil company petitioners were correct in contending that an oil and gas lease constitutes a sale of gas in interstate commerce, then the signatory landowner would be required, by Section 4(c) of the Act, to file the lease with the Commission as a rate schedule. This stretch of Commission jurisdiction would call for a deluge of hundreds of thousands of oil and gas leases. In an effort to avoid that inundation, ordering Paragraph (B) of Chairman White's opinion directed that:

> "For regulatory purposes such sales are covered by the filings of the producer-operators and payment by the producers to the royalty owners should be made as provided by the contractual provisions of each lease, except that in no event should the payment exceed the just and reasonable rates as fixed by the Commission under the Act."[27]

But the producer would have filed as a rate schedule the contract made between the producer and the pipeline company and to which the landowner is not even a party.

In the oil and gas lease—if it be the instrument of sale as those petitioners urge—the producer is the *buyer*. Ordering paragraph (B) would turn Section 4(c) of the Act upside down by using the *buyer's* rate filing to cover the *seller's* sale. The fiction of that approach is underscored by the fact that the landowner may never have agreed to accept a royalty calculated on the producer's sale price—never have agreed to

[27]Shell pet., app. p. 40a.

"sell" at the producer's rate. The Commission opinion recognized that fact by requiring payments from the producer (buyer) to the landowner (seller) to be made as provided by the "contractual provisions of each *lease*" rather than by the rate schedules under which the Commission says "such sales are covered". It is a complete contradiction to say that the landowner's "sale" is covered by the producer's filing and yet to say that the rate payable to the landowner is not the rate set out in the producer's filing. It would be equally nonsensical, however, to say that a landowner, who had contracted with the producer for a royalty calculated on a fraction of the production say at five cents per MCF, would be bound to accept royalty calculated on a four cent rate established in a producer's filing for its sale to the pipeline—for the very obvious reason that the landowner never agreed with anybody on that four cent price. In fact, that price is flatly inconsistent with the only agreement that the landowner did make.

These contradictions—besides signaling the Pandora's box of problems which the jurisdictional extension would open[28]—more basically constitute a *reductio ad absurdum* of the nonsensical pretense that a part of the lease constitutes a gas sale by the landowner and he is "therefore" somehow bound by a sale contract between the lessee and the pipeline to which he was never a party.

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[28]Cf. the observation of the Court of Appeals that ". . . if the FPC's jurisdiction over royalty owners were sustained its regulatory problems might be more complicated than it has assumed." Shell pet., app. p. 20a.

The petition of the Commission, on the other hand, seems to say that the gas purchase contract between the lessee-producer and the pipeline is the instrument of sale by the landowner. To avoid the obvious answer that the landowner cannot have made a sale by that contract since he is not even a party to it, that petition suggests a new legal fiction:

> "In entering into an oil and gas lease, a royalty owner, in effect, appoints the lessee-producer as its *agent*. Under the lease, the producer is obligated to develop the leasehold and market any gas produced therefrom."[29]

From this we suppose it is intended for the Court to infer that the landowner, as principal, has sold gas to the pipeline company under a contract made for the landowner by the lessee-producer as an authorized agent. But this reasoning defies reality in a number of significant respects.

A principal has a basic right to control the actions of his agent. Yet the landowner cannot control the sale by the lessee-producer. In the same paragraph of its petition the Commission concedes that "a royalty owner has *no* control over the incidents of such a sale" and then inexplicably criticizes the Court of Appeals for giving any determinative weight to that fact.

It makes no sense at all to treat an oil and gas lease which expressly requires royalty payments on gas production to be computed on one basis as constituting an implied authorization for the lessee to

[29]FPC pet. 9.

enter into a contract with someone else that would substitute different payments to the landowner computed on another basis. How can it be rationally argued that a principal has authorized his agent to make a contract with a third party which constitutes an amendment of the agreement between the principal and the agent?

To come back to the real world—the Burnett Trustees did not choose to go into the gas production business. Theoretically they could have done so as owners of the land—though probably not without violating applicable laws on lawful investments by trustees—but the fact is they did not. Instead they leased the land to Huber. They reserved no gas. They sold no gas. Yet from the mere existence of a rejected possibility the Commission's new argument would put the Burnett Trustees in the gas business by implication:

> "If the royalty owner had not entered into the lease, but had itself developed and sold in interstate commerce the natural gas underlying its property, it would clearly be subject to the Commission's jurisdiction. The fact that the royalty owner designates another to develop and market the gas should not operate to bar Commission jurisdiction over the retained fractional interest of the royalty owner in the sale of the gas."[30]

The implications are simply contrary to fact. The Burnett Trustees did not "designate" anyone to develop and market gas for them. They leased land to Huber so Huber could develop and market gas for

[30]FPC pet. 9-10.

Huber. That a royalty is payable with respect to a fraction of Huber's production is a far cry from a principal-agency relationship. The several analogies in the Court of Appeals opinion, we believe, are proper and pertinent.[31]

Mobil, reading far more into the decision below than is there, concludes that it "disposes of questions pending in numerous fora".[32] Lessor-lessee differences are neither new nor catastrophic. They have been before many judicial forums many times.[33] The decision below undertakes to dispose of no substantive questions. It merely holds that the judiciary, not the FPC, is the place to resolve lessor-lessee controversies.

Mobil's petition p. 26 sounds another alarm:

> "The record shows that at least one state court has already concluded that the royalty owner should be paid on the basis of 'market value' even where a payment clause provides only for payment of a share of 'proceeds'."

If some state judge has committed that error, the remedy is by appeal. To suggest that an incorrect state court decision on a question of lease construction justifies a demand by the wronged party that the United States Supreme Court rewrite a federal statute to expand the authority of an administrative agency is really too much.

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[31]Shell pet., app. p. 162.

[32]Mobil pet. 21.

[33]See, e.g., *Phillips Petroleum Company v. Bynum*, 155 F.2d 196 (5th Cir. 1946); *Union Producing Co. v. Pardue*, 117 F.2d 225 (5th Cir. 1941); *Chicago Corporation v. Wall*, 156 Tex. 217, 293 S.W.2d 844 (1956); *Arkansas Natural Gas Co. v. Sartor*, 78 F.2d 924 (5th Cir. 1935), cert. den. 296 U.S. 656.

If there is to be any order in our jurisprudence, the determination of the Court of Appeals that a landowner who grants an oil and gas lease on a naked piece of ground is not a natural gas company making a sale of gas in interstate commerce must be correct. And certiorari is not needed to say so. Commissioner Carver aptly described Chairman White's reasoning to the contrary as "a bootstrap conclusion [which] taxes credulity to the breaking point."[34]

All this country needs to bring complete chaos to gas regulation is a judicial extension of FPC jurisdiction over thousands of oil and gas leases and the landowners who have rights and obligations under those leases.

The Court of Appeals properly held that Congress *intended* no such thing. Section 1 of the Act expressly refers to the reports of the Federal Trade Commission and declares that "the *business* of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest."[35] A mere landowner of an Oklahoma farm or a Texas ranch is hardly in that business. As this Court has taught, the

[34]Shell pet., app. p. 46a. The issue has received scholarly scrutiny in two separate law review commentaries on the Fifth Circuit's decision in *J. M. Huber Corp. v. Denman, supra.* Both writers reach the same conclusion. The article in 42 New York University Law Review 552, 559 (1967) analyzes the question and expresses this view as to the proper interpretation of the statute:

> "Thus Huber, in asking the FPC to regulate the royalty payable to the lessor, seeks protection for an interest not covered by the act. Whether the FPC should control the terms on which gas rights may be leased is for Congress to decide."

The editor in 45 *Texas Law Review* 765, 771 (1967) reaches the same conclusion. We commend to the Court both of those fine law reviews.

[35]52 Stat. 821, 15 U.S.C. § 717(a).

Federal Trade Commission reports—on which "the 1938 Act was based"[36]—were concerned with anything but the thousands of landowners in all the gas producing states:

> "Moreover, the investigations of the Federal Trade Commission had disclosed that the majority of the pipe-line mileage in the country used to transport natural gas, together with an increasing percentage of the natural gas supply for pipeline transportation, had been acquired by a *handful of holding companies*. State commissions, independent producers, and communities having or seeking the service were growing quite helpless against these combinations. These were the types of problems with which those participating in the hearings were preoccupied. *Congress addressed itself to those specific evils.*"[37]

Finally, Shell contends that even though the landowner makes no *sale*, the courts should impose FPC jurisdiction over the oil and gas lease on an "additional" ground. In essence the argument is that the FPC *should* have jurisdiction over gas royalties because they constitute costs which *affect* interstate sales by regulated companies. This Court is thus asked to repudiate its prior tripartite analysis[38] and add a fourth jurisdictional category.

From the premise that ". . . the price to be paid for [sic] royalty interests has a direct and substantial effect on the price paid by the ultimate consum-

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[36] *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 9 (1961).
[37] *FPC v. Hope Natural Gas Company*, 320 U.S. 591, 610 (1944).
[38] *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947) — quoted above at p. 6.

er,"[10] Shell would conclude that landowners are natural gas companies under the Act. But the Act says no such thing. A royalty payment to those upon whose land wells are drilled is only one of a myriad of costs which have a direct and substantial effect on the price paid by the ultimate consumer. Congress, however, directed the FPC to regulate the *sale* of gas and the *seller*—not the *costs* incurred by the seller nor the persons to whom such costs are paid.

With respect to Shell's "necessity" argument the Court of Appeals wrote:

> "If an interpretative ruling *stretching* the Act as written to cover leases by landowners is to be countenanced on the score of necessity, and we do *not* say this will be possible, the underlying record must be more comprehensive and profound—broader and deeper, as it were—than the findings and analysis presented on this record."[11]

From this foundation, petitioners argue that the Court of Appeals should have remanded for further administrative hearings. Not so. Any thought of stretching the Act because of someone's idea of necessity is more properly directed to Congress. This Court has said it well:

> ". . . the determinative question is not what the Board thinks it *should* do but what Congress has said it *can* do."[12]

The Court of Appeals for the District of Columbia

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[10] Shell pet. 8.
[11] Shell pet., app. p. 18a.
[12] *Civil Aeronautics Board* v. *Delta Airlines*, 367 U.S. 316, 322 (1961).

Circuit is not noted for restrictive interpretations on questions of administrative agency jurisdiction. Its conclusions in this case are eminently correct.

There Is No Conflict of Decisions

The decision of the Court of Appeals is completely consistent with prior law. As mentioned earlier, this Court has held that the Act grants jurisdiction over interstate *transportation*, interstate *sales* and *companies* engaged therein and nothing more.[42] The Court below followed that guidance.

This Court has also held that a landowner who receives royalties under an oil and gas lease is not a seller of production from the lease. In considering whether such a royalty owner makes a "sale" under a taxing statute applicable to sales, Justice Stone differentiated between royalty receipts and sale proceeds:

> "[T]he statute speaks of a 'sale' and these leases would not generally be described as a 'sale' of the mineral content of the soil, using the term *either* in its technical sense or as it is commonly understood. **Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas.** By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill, and produce oil and gas if found."[43]

The decision below likewise holds that a landowner

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[42] *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947) – quoted at p. 6 above.

[43] *Burnet* v. *Harmel*, 287 U.S. 103, 107 (1932)

by receiving royalties under an oil and gas lease, does not thereby make a sale of gas. This is true, using the term in its commony understood sense—and also in its technical legal sense."[44]

The argument that the FPC has jurisdiction over payments by lessee-producers to royalty owners was rejected by the Texas courts in a 1957 action by a royalty owner against his lessee over the amount of royalty payable:

> "Respecting the FPC rates, the regulatory body simply made no effort to and did not fix a rate as between LeCuno and these litigants . . . The FPC wisely made no effort to come between the producer and its royalty owners and left the matter of costs and charges as between them to their own arrangement. . . . The regulatory authority of FPC is not involved in this suit. Nor can it be said that that agency has exclusive jurisdiction of the controversy between these litigants or even that there is *any* controversy between the litigants that the FPC in the exercise of its *lawful* authority might determine."[45]

And this Court *refused certiorari* to review that deter-

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[44]Citing the Fifth Circuit opinion in *J. M. Huber Corp.* v. *Denman*, 367 F.2d at 113-114, the Court below noted:

> "[The lessors make] the very simple, yet profound, contention that there can be no 'sale' of gas by royalty owners since they have no gas to sell. And this seems to be true as a matter of oil and gas law, whether based on the ownership-in-place concept followed by Texas and others or on non-ownership theories of other jurisdictions. For *all agree* that as the gas leaves the well-mouth, the entire ownership of the gas *is* in the lessee, none being reserved in the lessor."

Shell pet., app. p. 10a.

[45]*LeCuno Oil Company* v. *Smith*, 306 S.W.2d 190, 193-4 (C.C.A. Tex. 1957); writ den. n.r.e. (Texas Supreme Court).

mination.[46] The decision below is also consistent with that precedent.

Petitioners, on the other hand, urge a holding which would necessarily conflict with this Court's explanation in *Mobile* of the scheme of the Natural Gas Act.

> "The basic power of the Commission . . . is simply the power to review rates and contracts made in the first instance by natural gas companies . . ."[47]

If, as petitioners contend, landowners were natural gas companies, then the royalties payable would be those established initially by agreement with the landowners. Instead the oil company petitioners would *impose* upon the landowners rates established by agreement between the oil companies and the pipeline. Mobil, for example, confesses that it would insist that royalty payments be limited to a share of the lessee's proceeds no matter what the lease said to the contrary.[48]

The Commission's petition suggests that the Commission has given a nod to the *Mobile* principle by holding "that royalty rates for interstate sales are to be governed by either the rate provided for in the lease or the just and reasonable rate as determined by the Commission, whichever is lower."[49] This would impose an area rate on landowners as a result of area proceedings to which landowners were never made

[46] Ibid., 356 U.S. 974 (1958).
[47] *United Gas Pipe Line Co. v. Mobile Gas Service Corporation*, 350 U.S. 332, 341 (1956).
[48] Mobil pet. 21-23.
[49] FPC pet. 7.

parties.[50] Then the Commission's petition, in the same paragraph, rejects the *Mobile* principle that the landowner (if it were a natural gas company) should initially make the "rate". Specifically it argues:

> "Where the just and reasonable rate has not yet been determined by the Commission, royalties are to be governed by the *producer's* effective rates, subject to adjustment upon establishment of the just and reasonable rate."

The decision below, by rejecting the pretense of a "sale" by a landowner who in reality makes no sale, remains consistent with *Mobile*.

Also the negation of FPC jurisdiction over royalties payable under oil and gas leases is consistent with the landmark *Panhandle Eastern* doctrine. Commissioner Carver put the proposition well:

> "In point of time and the legal and economic interests created, primary lease execution is clearly antecedent to any facet of 'production and gathering.' The lease constitutes the very essence of the relationship between landowner and lessee-producer. If the language in *F.P.C. v. Panhandle Eastern Pipeline Co.* (1949) 337 U.S. 498, 505, holding 'leases an essential part of production' is not controlling here, it is difficult to conceive of a case where it would be."[51]

Petitioners assert that the decision below is in conflict with three decisions of this Court in *Phillips*[52]

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[50]Cf. Court of Appeals analysis, Shell pet., app. p. 20a.

[51]Shell pet., app. p. 51a.

[52]*Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

Rayne,[33] *Bastian Bay*,[34] and with the "filed rate" doctrine.[35] The court below—in our view correctly—saw no such conflict.

Phillips involved only the question of FPC jurisdiction over an admitted *sale* by a lessee-producer. It has no bearing on the efforts of petitioners to extend that jurisdiction to landowners who receive royalties under oil and gas leases but who make no sale.

Rayne and *Bastian Bay* were companion cases. In fact *Bastian Bay* was summarily reversed in a per curiam memorandum decision which simply cited *Rayne*.[36] The Court below carefully analyzed these decisions and found no conflict. In *Bastian Bay* and *Rayne*, as pointed out by the Court of Appeals, this Court was confronted with "a transaction that was in *form* a lease of reserves but in economic impact the equivalent of 'conventional sales of natural gas' ".[37] Distinguishing that situation from ours the Court of Appeals accurately held:

"When we come to an ordinary lease by the

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[33]*United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965).

[34]*Federal Power Commission v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965).

[35]*Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951).

[36]Interestingly Amoco, of all people, refers to the "importance of this case to natural gas consumers and the natural gas industry" as similar to *Phillips*, *Bastian Bay*, and *Rayne* (Amoco pet. 9) and describes *Bastian Bay* and *Rayne* as examples of "parties seeking to avoid rate regulation". (Amoco pet. 14). They should know whether *Bastian Bay* and *Rayne* were avoidance cases for Amoco, under its then name of Pan American Petroleum Corporation, *was* the petitioner in *Bastian Bay*. There however, contrary to what it now says, Amoco assured the court that it was *not* using a subterfuge to avoid rate regulation.

[37]Shell pet., app. 13a.

> landowner to the producer there is neither a 'customary' sale in interstate commerce nor its equivalent in economic effect. Such a lease is a transaction that is itself customary and conventional, but one that precedes the 'conventional' sales in interstate commerce with which Congress was concerned, indeed even precedes the 'production and gathering' which § 1(b) visualized as preceding the sale in interstate commerce over which jurisdiction was being established."[58]

Amoco goes full tilt. In an effort to bring this case within those decisions, they accuse the Court below of permitting landowners "to utilize technical concepts of local law of sales to avoid rate regulation by simply *casting the transaction* in such a form"[59] as an ordinary oil and gas lease. Again they argue that the Court below permits landowners to employ concepts of local law "in *formulating* gas royalty clauses that exempt payment of royalty interests in gas sold from Commission rate regulation."[60] These charges assume, contrary to fact, that landowners have designed oil and gas leases to circumvent intended regulation under the Act. Nothing could be further from the truth. Most oil and gas lease forms have been designed by oil companies themselves—not by landowners—and in large part they antedate even the passage of the Natural Gas Act. There is nothing in the record of this case or elsewhere to suggest that these lease forms have been prepared as an escape mechanism.

Lastly Cities Services searches for a conflict with

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[58]Shell pet., app. p. 14a.
[59]Amoco pet. 8.
[60]Amoco pet. 13.

the "filed rate" doctrine announced by this Court in 1951[61] and they argue that "there can be no retroactive changes of rate made effective without suspension under Section 4 of the Natural Gas Act."[62] This begs the question. The "filed rate" doctrine precludes changes, except by following the statutory procedure, in a rate previously filed with the Federal Power Commission by a natural gas company covering its sales. There is nothing in that doctrine remotely prohibiting the natural gas company from making royalty payments in compliance with its leases. If, as petitioners would have it, landowners were to be regarded as natural gas companies, then as a beginning point they would surely be entitled to receive the "rates" called for by their oil and gas leases unless and until the Commission had held a hearing finding such "rates" unlawful and prescribing new ones.[63]

Petitioners seek by administrative brute force to convert all gas lease royalty clauses into "proceeds" clauses without a hearing—with disregard to what the landowners and their lessees may have agreed to —and without filings or hearings before the Commis-

[61] *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951).

[62] Cities Service pet. 14-15.

[63] *United Gas Pipe Line Company v. Mobile Gas Service Corporation*, 350 U.S. 332 (1956). See also the holding in *Phillips Petroleum Company v. Federal Power Commission*, 258 F.2d 906, 914-5 (10th Cir., 1958):

> "It seems clear to us, therefore, that the price which Phillips was entitled to receive and Panhandle was obligated to pay, by the terms of the contract, on June 7, 1954, was the rate fixed and prescribed by the rate schedule and that such rate was *not* the price reflected by the billing statement or actually *being paid by the buyer* and received by the producer on June 7, 1954."

sion.[64] Mobil would excuse such strong-arming with the specious comment that "The 'royalty' owner bears no costs and does not engage in exploration and development."[65] This comment is consistent with the lack of a sale by the royalty owner. It is in conflict with the argument in the Commission's petition that the royalty owner has designated the lessee as an agent to explore and develop gas for him. See pp. 17-19 supra.

Besides, where would the oil companies of America be without access to the land which the landowner's oil and gas lease alone affords them? Where would this exploration and development be conducted if oil and gas leases were not available? By what process of reasoning does Mobil Oil Corporation look upon its payment of royalty to the landowner as some sort of a gratuity?

At page 26 of its petition Mobil foresees (with really no basis) massive increases in royalty payments unless the FPC immediately extends its jurisdiction to oil and gas leases and this, they imply, is contrary to the public interest. What a contrast with the position of Mobil a few short years ago before the Supreme Court of Texas.[66] In that instance Mobil itself had become the owner of some mineral interests. Gas royalties were being paid by Pan American (now

[64]**One wonders how this technique would apply to the thousands of leases to pipeline companies. In those situations the *only* sale of gas is by the pipeline company under tariffs which are many times *higher* than the field market price.**

[65]Mobil pet. 25.

[66]*Southland Royalty Company v. Pan American Petroleum Corporation*, 378 S.W.2d 50 (Tex.Sup.Ct. 1964).

Amoco) at a rate of $100 per well. Mobil thought nothing of suing to increase those payments to a royalty share of almost a million dollars worth of gas production.[67] And—most significantly—neither Mobil nor Amoco turned to the FPC in that royalty dispute although the gas was being sold by the producer in interstate commerce. Yet they now both tell this Court that the FPC has had jurisdiction over such matters for eighteen years.

The Case Involves No Matter of Serious National Concern

The controversies before this Court are private disputes between a very few major oil companies[68] and a relatively small number of individual landowners. Notwithstanding the FPC's open invitation for participation by anyone interested in the hearings below, the case has essentially been ignored by all interstate pipelines, all state regulatory agencies, virtually all distribution companies, and the vast majority of producers. That would not have been the case if significant issues of national import had been at stake.

Understandably petitioners strain to find grave consequences in their effort to provoke action by this Court. Shell speaks of national supply shortages:

> "The present crisis in the nation's supply of natural gas has received the recognition of the

[67] *Southland Royalty Co. v. Pan American Petroleum Corp.*, 354 S.W.2d 184, 190 (Tex. C.C.A. 1962).

[68] Mobil, Amoco, and Huber supported by intervenors, Shell and Cities Service.

> Courts and is receiving the continuing attention of the Federal Power Commission."[69]

The tacit implication is that the solution to gas shortages is an expanded FPC jurisdiction. Most knowledgeable parties (including Shell in other forums) feel just the opposite. To subject landowners to regulation of a federal administrative agency simply because lessees of their lands produce and sell gas in interstate commerce would hardly be calculated to increase the available leaseholds without which drilling and production are impossible. Common sense compels the conclusion that many landowners would refuse to lease their lands or lease it upon condition that gas sales be made only in intrastate commerce.

Mobil utilizes the technique of large numbers by alluding to the fact that royalty is paid with respect to "13,000,000 million cubic feet sold each year" subject to FPC regulation.[70] The point is that *all* of that "13,000,000 million cubic feet" is already subject to FPC control as it is sold by the producer in interstate commerce. Only four or five major oil companies think regulation must be expanded behind the sale and over the seller's royalty costs in order to remain effective.

With mounting momentum Mobil resorts to coercive threats to have all the area rate proceedings nullified unless this Court agrees to their petitions for certiorari:

> "A more immediate result will be that if the opinion below should become final, petitioners

[69]Shell pet. 11.
[70]Mobil pet. 16.

> must seek immediate remand to the Commission of four 'area rate' cases now on review and by which the Commission had fixed rates for more than 60 per cent of the natural gas moving in interstate commerce."[71]

We question whether Mobil really would seek any such remand but, in any event, Mobil seeks many things which Mobil does not get. Amoco raises similar specters:

> "Even so, the administrative burden of processing rate schedule filings by royalty interest owners that may be required would be insignificant when compared to the burden of (1) reopening past and pending area rate proceedings, (2) revising the area rate method of regulation, and (3) intervening in state court suits brought by royalty owners which would be required if the opinion of the Court below is allowed to stand."[72]

Not even Chairman White, in writing his opinion in support of jurisdiction, saw any consequences even remotely resembling those described by Mobil and Amoco.

The Commission's petition says, "unless overturned, the decision will significantly inhibit the Commission from effectively regulating the rates at which such gas is sold."[73] There is no justification for that fear. And if the FPC really needs expanded jurisdiction to do its job, Congress is the proper body to grant such enlargement. Actually the Commission has regulated

[71]Mobil pet. 20.
[72]Amoco pet. 16.
[73]FPC pet. 8.

pipeline rates since 1938 and producer rates since 1954 without experiencing the slightest difficulty from lack of jurisdiction over landowner royalties.

We suspect that this is not the first time this Court has seen consequences of decisions below grossly exaggerated. And we doubt that anything we could say further would make those exaggerations more evident than they already are.

CONCLUSION

The Court of Appeals issued a tightly reasoned, highly professional opinion. It properly disposes of a rather clear cut legal issue. Certiorari to reconsider that issue in the highest court of the land is unnecessary and should be denied.

Respectfully submitted,

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